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IN THE

Supreme Court of the United States

OCTOBER TERM 1971

Docket No. 71-1197

O'NEILL RYAN and UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee of a Trust dated April 15, 1968 for the benefit of Sara Ryan Hill,

Petitioners,

against

J. WALTER THOMPSON COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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March 17, 1972

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IN THE

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OCTOBER TERM 1971

Docket No.

O'NEILL RYAN and UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee of a Trust dated April 15, 1968 for the benefit of Sara Ryan Hill,

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J. WALTER THOMPSON COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners, O'Neill Ryan and the United States Trust Company of New York (hereinafter "Ryan"), seek a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit, affirming a final judgment of the United States District Court for the Southern District of New York. Petitioners seek the aid of this Court to correct a material misinterpretation of the common law of New York and to clarify the disclosure requirements mandated by Section 10(b) of the Securities Exchange Act of 1934 [15 U.S.C. § 78j]; and the SEC Rule 10b-5 [17 C.F.R. 240.10b5].

In determining the validity of a close corporation's option to repurchase its stock under the law of New York, the Second Circuit has sanctioned a violation of the time-honored rule that there be no unreasonable restraint on the free alienation of property. Specifically, that Court has ruled that a corporation's first option to repurchase its stock, which option effectively restricts transfer of those securities, is reasonable in and of itself, regardless of whether or not the corporate purpose originally underlying the opinion no longer exists.

In so ruling, the Second Circuit failed to consider the impact of a close corporation's decision to "go public" upon the validity of an option which was originally intended to maintain a close corporate identity. Moreover, the Court's per se analysis is in conflict with the established law of New York, which requires the Court to consider all of the facts and circumstances surrounding the exercise of an option in order to determine its reasonableness as a restriction on transfer.

Additionally, the Second Circuit determined that a close corporation need not disclose to a selling shareholder its decision to "go public" and the resulting invalidity of its option. In reaching its determination, the Second Circuit totally disregarded the disclosure requirements mandated by the federal securities laws. The failure to apply these statutory provisions in this case paves the way for continued substantial abuse of first option provisions in connection with every public offering involving a corporation which was previously closely held.

Opinions Below

The opinion of the Second Circuit is appended hereto as Appendix "A"; the opinion of the District Court is reported at 322 F. Supp. 307 (S.D.N.Y. 1971).

Jurisdiction

The Second Circuit's order affirming the final judgment of the District Court (which had granted summary judgment to respondent) was entered on November 18, 1971. A petition for rehearing *en banc* was denied by order of the Second Circuit on December 20, 1971. Accordingly, this petition is timely filed. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1). The original judisdiction of the District Court was invoked under § 27 of the Securities Exchange Act of 1934 [15 U.S.C. § 78aa] and the doctrine of pendent jurisdiction.

Questions Presented

1. Is a close corporation's first option to repurchase its stock valid per se, or may a change in circumstances and conditions subsequently render the repurchase option invalid as an unreasonable restraint upon alienation?

2. May a close corporation which has decided to "go public" and to remove transfer restrictions on its stock, thereafter continue to exercise options to repurchase its stock at prices far below the true value thereof, pursuant to an option agreement, the validity of which agreement depended upon the continued existence of the corporation's close identity?

3. Does a close corporation's failure to advise a selling shareholder of (1) its decision to "go public", (2) the resulting invalidity of its repurchase option, and (3) the anticipated substantial appreciation in the value of shares repurchased, constitute a violation of the anti-fraud provisions of the federal securities laws?

Statement of the Case

In this action, Ryan seeks to rescind sales of J. Walter Thompson Company ("Thompson") stock made by him to Thompson in January 1969, pursuant to Thompson's exercise of certain repurchase options. The gravamen of Ryan's complaint is that at the time these options were exercised, Thompson had decided and in fact taken steps to "go public" and that as a result thereof the options were unenforceable, since they were no longer supported by a valid corporate purpose and therefore constituted an unreasonable restraint upon alienation under the law of New York. Additionally, Ryan claims that Thompson's failure to disclose the contemplated public offering, the resulting invalidity of its option and the anticipated appreciation in the value of stock held by Ryan, prior to the time it repurchased Ryan's stock, constituted a violation of the anti-fraud provisions of the federal securities laws.

The Litigation

The litigation was commenced by the filing of a summons and complaint on May 26, 1969. Thompson's answer denied the material allegations of Ryan's complaint and asserted a counterclaim seeking to recover the amount that Thompson had paid Ryan upon the purchase of his stock in January 1969, plus dividends.

Following completion of discovery proceedings, both parties moved for summary judgment, each alleging that there was no genuine issue as to any material fact and that summary judgment was appropriate. Ryan argued before the District Court that under the law of New York, the restraint upon alienation imposed by Thompson's option on his stock must be "reasonable" under all circumstances in order to be valid, and that the Court must look to the

purpose supporting the restraint in order to determine its reasonableness.

By order entered on January 29, 1971, the District Court granted Thompson's motion, holding that it was entitled to judgment "as a matter of law." By this same order, Ryan's motion for summary judgment was denied and Thompson's counterclaim was dismissed. The District Court rejected Ryan's contention, holding that under New York law a first option provision is "in and of itself . . . reasonable" [322 F. Supp. at 313] and that no other purpose or object is necessary to justify its validity. The District Court further ruled that since Ryan was under a compulsion to sell his securities to Thompson, there could be no violation of federal securities laws.

The Facts

During the course of his employment with Thompson, Ryan purchased shares of Thompson's common and preferred stock. All of the stock purchased was subject to certain transfer restrictions and repurchase options which effectively restrained free alienability. The avowed purpose of the restrictions, which are set forth in Thompson's Certificate of Incorporation, was to enable Thompson to remain as a close corporation.

On January 31, 1966, Ryan retired from the active employ of Thompson, having achieved the position of Vice President and Director. Pursuant to the terms of its Certificate, Thompson reserved an option to call Ryan's stock. This option arose on the first day of January in the third calendar year following retirement and remained effective for 90 days. In the event this option expired and Ryan received a subsequent offer to purchase his stock, Thompson reserved an additional option to repurchase the stock, either at the price stated in the offer to Ryan or at the "call price"*, whichever was lower.

* The "call price" was based upon the net asset value of the corporation, specifically excluding good will.

On January 14, 1969, Thompson exercised its option and purchased Ryan's stock at the "call price", paying Ryan $276,200. Significantly, prior to the repurchase of this stock and at least as early as November 1968, the Thompson management had made a decision to "go public". In point of fact, as early as August 1968, Thompson, in need of working capital, had planned and taken steps toward a public offering. Thus, in August 1968 Thompson met with Morgan, Stanley & Co., its investment banker, to discuss the possibility of that firm's managing the underwriting of Thompson's public offering. On October 4, 1968, Morgan Stanley recommended that Thompson commence preparation for a public offering.

On November 13, 1968, Breed, Abbott & Morgan, Thompson's counsel, advised Thompson that it could legally exercise those options becoming due in January 1969. The opinion was sought by Thompson in light of the fact that it expected to "go public" during the course of 1969. On November 15, 1968, Breed, Abbott & Morgan commenced work on a prospectus for Thompson in connection with the public offering, the first draft of which was completed on November 27, 1968. Throughout January and February 1969, Thompson had discussions with its major clients concerning the possibility of filing its registration statement with the SEC in March 1969.

On March 28, 1969, Thompson filed its printed Form S-1 Registration Statement with the Securities and Exchange Commission in Washington, D.C. Finally, on June 4, 1969, Thompson made a public offering of 790,000 shares of its common stock. As of the date of the offering, the stock which Ryan sold to Thompson under option compulsion in January 1969 for $276,200 had a value of $1,026,000 as a result of Thompson's recapitalization and the addition of "good will" to the value of the stock. At no time prior to the exercise of the option in question did Thompson disclose to Ryan its decision to "go public" and the impact of that decision upon the validity of the Thompson option.

The Second Circuit's Opinion

In affirming the judgment of the District Court dismissing Ryan's action, the Second Circuit upheld the lower court's per se analysis and ruled that the Thompson option did not constitute an unreasonable restraint upon alienation. In so ruling, the Second Circuit failed to consider the impact of Thompson's decision to "go public" upon the validity of the option; instead, it chose to limit the scope of its inquiry to the four corners of the option agreement. Thus, in determining that Thompson's option did not constitute an unreasonable restraint upon alienation, the Court held that a first option to a close corporation is valid irrespective of whether or not the corporate purpose underlying the option agreement no longer existed. In reaching its decision, the Circuit Court failed to inquire into the purposes underlying the restraint and the facts and circumstances existing at the time the option was exercised. The Circuit Court's failure to make such an inquiry not only produced an unjustified and unintended result, but more importantly, sanctioned a violation of the time-honored rule of New York law that there be no unreasonable restraint upon alienation.

The Circuit Court further ruled that "since Ryan was obligated to sell his shares to JWT in January 1969, whatever he knew or did not know regarding JWT's plans to go public was irrelevant". The Court's holding is predicated solely upon, and assumes the existence of, a valid and binding option agreement.

Reasons for Granting the Writ

As a consequence of its departure from the settled law of New York, and by reason of the broad impact and far-reaching effect the decision of the Second Circuit will have in the field of corporate and securities laws, the issues in

this litgation involve questions of exceptional national importance which should be reviewed by this Court.

1. *The Second Circuit has decided an important question of law in a way that is irreconcilably in conflict with the applicable state law.*

Ryan argued before the Second Circuit that under the law of New York the restraint upon alienation imposed by Thompson's option must be "reasonable" in order to be valid, and that the Court must look to the purposes supporting the restraint in order to determine its reasonableness. That Court flatly rejected Ryan's contention, holding that an option would be invalid only if it "prevented transfer of the stock as opposed to merely delaying transfer, as here, by giving the corporation the right of first refusal." This rigorous application of a per se rule with respect to the validity of the Thompson option is erroneous and irreconcilably in conflict with the law of New York.

Under the law of New York, shares of corporate stock are regarded as personal property subject to the "time-honored" rule that there be no unreasonable restraint upon their alienation. [*Allen* v. *Biltmore Tissue Corp.*, 2 N.Y. 2d 534 (1957).] The New York Court of Appeals has expanded on this "property concept" in *Biltmore*, by stating that the courts of New York, "as Section 176 of the Personal Property Law implies", will sustain a restriction imposed on the transfer of stock only if it is "reasonable" [*Id.* at 541].

Similarly, in *Penthouse Properties, Inc.* v. *1158 Fifth Avenue, Inc.* [256 App. Div. 685 (1st Dept. 1939)], the court declared "the general rule that ownership of property cannot exist in one person and the right of alienation in another . . . has in this State been frequently applied to shares of corporate stock . . . and cognizance has been taken of the principle that 'the right of transfer is a right of

property, and if another has the arbitrary power to forbid a transfer of property by the owner that amounts to annihilation of property' " [*Id.* at 690-91].

In discussing the scope of the judicial inquiry necessary to determine the validity of a particular restraint, the court stated:

> "[I]f [a] restraint on alienation of the stock may be said to be imposed at all, it is a restraint which in every respect is reasonable and appropriate to the lawful purposes to be attained." [*Id.* at 692]

Thus, it is clear that under the law of New York the "reasonableness" and validity of the option herein rests squarely upon the surrounding facts and circumstances; more particularly, upon a determination of whether or not any lawful purpose supported the option at the time of its exercise. Contrary to the Second Circuit's holding, *the fact that the option does not totally prevent transfer does not obviate the question as to whether there is any lawful purpose supporting the option at the time of its exercise.* The Second Circuit's failure to determine this issue constituted a radical and unfound departure from the established law of New York.

It is significant that neither in *Biltmore* nor *Penthouse Properties* was the court presented with a contention that the options there in issue were no longer supported by any legitimate corporate purpose. To the contrary, in both those cases the options continued to serve a legitimate corporate purpose, *e. g.*, keeping a close corporation closed.

Sands Point Land Co., Inc. v. *Rossmoore* [43 Misc. 2d 368 (Sup. Ct. 1964)], is the only reported New York case in which the lawful purpose supporting the option no longer existed at the time of its exercise. There, the court refused to permit a corporation to exercise its first option to repurchase, when the directors had already made a decision to dissolve the corporation. The reasoning of the court, which is fully applicable here, is stated as follows:

> "The restrictive stock agreement is a device to assure 'the succession in interest of persons most likely to act harmoniously with the other shareholders'. In the instant case this *rationale* does not apply since there will be no 'succession in interest' inasmuch as the corporation is ceasing to exist. . . ." [Id. at 372]

Here, Thompson's decision to "go public" is fully comparable to the decision in *Sands Point* to dissolve the corporation. In both instances, the corporate decision eliminated the necessity for a "succession in interest" which previously constituted the lawful purpose supporting the existence of the option restriction. Of critical importance in *Sands Point* is the court's analysis of the change in corporate structure and its impact on the validity of the first option.

The decision in *Sands Point,* rendered seven years after *Biltmore,* points out that when determining the validity of an option the courts of New York will not restrict their consideration to the four corners of the option agreement, as the Second Circuit has done in this case. More specifically, under the law of New York, the validity of an option agreement does not rest solely upon the issue of whether that agreement totally prevents transfer but, as *Biltmore, Penthouse* and *Sands Point* make clear, upon whether or not there is any lawful corporate purpose supporting the existence of the option at the time of its exercise. The Second Circuit's summary dismissal of petitioners' contentions below and its per se analysis as to the validity of the Thompson option is an aberration of the settled law of New York.

2. The decision below defeats the congressional intent in enacting Section 10(b) of the Securities Exchange Act of 1934, rejects the SEC's purpose in promulgating Rule 10b-5 and conflicts with prior judicial interpretations given to the Act and Rule.

In affirming the District Court's judgment with respect to Ryan's Rule 10b-5 claim, the Second Circuit held that

whatever Ryan knew or did not know regarding Thompson's plans to "go public" was "irrelevant". Obviously, this conclusion assumes the validity of the Thompson option. As previously demonstrated in this petition, once Thompson made its decision to "go public", its option to purchase Ryan's stock was no longer enforceable. The resulting invalidity of the option mandated that Thompson disclose to Ryan the material information that it had decided to "go public" and in fact had taken concrete steps to implement that decision. Section 10(b) and Rule 10b-5 clearly interdict the non-disclosure of material information and facts in connection with the sale or purchase of any securities.* In connection with Ryan's purchase of Thompson's stock, one can conceive of no more material information than that Thompson had decided, and had in fact taken steps, to "go public" and that as a result thereof the option to repurchase had become void and unenforceable. It is Thompson's failure to disclose this material information which constituted an individual violation of federal law, i.e., Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.

The fact is, that as of January 14, 1969, there was a strong probability that Thompson would "go public" and indeed would do so in the very near future. The non-disclosure of the decision to "go public" and the steps taken toward that end undermined and destroyed the equality of bargaining position clearly envisioned by the framers of Section 10(b) and Rule 10b-5.

Thompson alone was in a position to evaluate the probability and expectation of a public offering and the anticipated magnitude of that event. This inequity based upon

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* A material fact is "one to which a reasonable man would attach importance in determining his choice whether to make the sale or not". [*Ross* v. *Licht*, 263 F. Supp. 395, at 408 (S.D.N.Y. 1967), citing with approval *List* v. *Fashion Park, Inc.*, 340 F.2d 457, at 461-63 (2d Cir. 1965), *cert. denied*, 382 U.S. 811 (1966)].

unequal access to critical information goes to the heart of the federal securities laws and petitioners' claim below should not have been mischaracterized by the Second Circuit as "wholly inappropriate and wide of the congressional mark". Moreover, the violation of the federal securities laws complained of herein is one of critical importance in light of the large number of close corporations which are currently going public in quest of working capital.

In an analogous situation, this Court extended the protection of the federal securities laws to employees who had purchased stock in a closely held corporation holding, *inter alia,* that § 4(1) of the Securities Act of 1933 [15 U.S.C. § 77d] was applicable to such sales. The Court noted that "[t]he focus of inquiry should be on the need of the offerees for the protections afforded by registration. The employees here were not shown to have access to the kind of information which registration would disclose. The obvious opportunities for pressure and imposition make it advisable that they be entitled to compliance with § 5". [*S.E.C.* v. *Ralston Purina Co.,* 346 U.S. 119, at 127 (1953)]

It is respectfully submitted that since Ryan's claim arose out of, and is bottomed upon, a public offering of securities made pursuant to the federal securities laws, a federal court is not only the most appropriate forum but, indeed, the only forum in which complete relief can be obtained. The decision of the Second Circuit countenances a grave injustice to Ryan and, in light of the frequency in which close corporations are "going public", may be expected to have a substantial and detrimental effect upon the rights of selling shareholders whose stock is called.*

*The Court is respectfully requested to take judicial notice of the fact that many closed corporations with option agreements similar to the one here in issue, including advertising agencies, stock brokerage firms and insurance agencies, are "going public" with increasing regularity.

Conclusion

For the foregoing reasons, petitioners request that their petition for writ of certiorari be granted.

Respectfully submitted,

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Appendix A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 67—September Term, 1971

(Argued November 4, 1971 Decided November 18, 1971.)

Docket No. 71-1385

O'NEILL RYAN and UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee of a Trust dated April 15, 1968 for the benefit of Sara Ryan Hill,

Plaintiffs-Appellants,

v.

J. WALTER THOMPSON COMPANY,

Defendant-Appellee.

Before:

WATERMAN, SMITH and TIMBERS,

Circuit Judges.

Appeal from summary judgment entered in the Southern District of New York, Inzer B. Wyatt, *District Judge*, 322 F. Supp. 307 (S.D.N.Y. 1971), in favor of defendant dismissing action brought pursuant to Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, the complaint also having asserted a state law claim under the doctrine of pendent jurisdiction.

Affirmed.

LEO T. KISSAM, New York, N. Y. (Anthony S. Genovese, Robert A. Warren, Michael F. Fitzgerald and Kissam & Halpin, New York, N. Y., on the brief), for Appellants.

Appendix A

EDWARD J. ROSS, New York, N. Y. (Miriam C. Feigelson and Breed, Abbott & Morgan, New York, N. Y., on the brief), for Appellee.

PER CURIAM:

This case is another example of a trend we have observed with disturbing frequency, namely, invocation of the salutary anti-fraud provisions of the federal securities laws in cases where those provisions are wholly inappropriate and wide of the Congressional mark. Moreover, the vice of this practice is compounded here by engrafting upon the misplaced federal securities law claim a state law claim that, but for the federal gloss, should have been litigated in the state courts.

Appellants, O'Neill Ryan and the United States Trust Company of New York, as Trustee,[1] appeal from a judgment entered in the Southern District of New York, Inzer B. Wyatt, *District Judge*, 322 F.Supp. 307 (S.D.N.Y. 1971), granting a motion by appellee, J. Walter Thompson Company (JWT), for summary judgment and dismissing the action brought by Ryan pursuant to Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5 (1971), the complaint also having asserted a state law claim under the doctrine of pendent jurisdiction.[2] Since we agree with the District Court's application of the law to the undisputed facts, we affirm.

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[1] Ryan's transfer in April 1968 to the United States Trust Company of certain JWT stock in trust for his daughter is of no significance here. Ryan and the Trust Company are treated as one for purposes of this appeal.

[2] The judgment of the District Court also dismissed JWT's counterclaim. No appeal has been taken from that part of the judgment.

Appendix A

In view of the District Court's clear, comprehensive and detailed statement of the facts, 322 F.Supp. at 308-312, it is sufficient for our purpose merely to state the claims asserted and the District Court's rulings thereon with which we agree.

The gravamen of Ryan's grievance is that, following his retirement on January 31, 1966 as a vice-president and director of JWT, the latter on January 14, 1969 exercised its option to purchase Ryan's stock in JWT at the net asset value of $276,200 (excluding any value for good will), as compared to the $970,650 value said to be attributed to such stock (including good will value) after JWT's public offering of its stock in June 1969.

Ryan had acquired his stock while employed by JWT. During this period JWT sold its stock only to its officers and employees. All such stock was subject to certain restrictions the purpose of which was to enable JWT to buy back its stock, at net asset value, whenever a holder desired to sell or ceased to be an officer or employee.

Beginning in August 1968, JWT, needing additional working capital, took steps to sell some of its stock to the public through a public offering, removing the restrictive options on such shares. A registration statement and preliminary prospectus were filed with the SEC on March 28, 1969. On June 4, 1969, the public offering of 27% of JWT's shares took place. This resulted in changing JWT from 100% to 73% employee-owned.

Ryan's action in the District Court was brought to rescind his sale of JWT stock in January 1969 pursuant to JWT's exercise of its options. Ryan's essential claims in this action are (1) that, since JWT had taken steps to go pubic when the options were exercised in January 1969, such options were unenforceable as an unreasonable restraint upon alienation under New York law (state law claim); and (2) that JWT's failure to disclose its contemplated public offering prior to its repurchase of Ryan's

stock constituted a violation of the anti-fraud provisions of the Securities Exchange Act of 1934 (federal law claim).

Since there is no basis for diversity jurisdiction, it is clear that there is no federal jurisdiction with respect to the state law claim referred to above unless pursuant to the doctrine of pendent jurisdiction. While the parties on appeal have not addressed themselves to this issue, we have examined the record ourselves. *Gem Corrugated Box Corp.* v. *National Kraft Container Corp.*, 427 F.2d 499, 501 n. 1 (2 Cir. 1970), and cases there cited. We agree with the District Court that it properly could exercise jurisdiction over the state law claim under the doctrine of pendent jurisdiction. And since we have discussed this subject recently, we see no need to dilate upon it here. See *Leather's Best, Inc.* v. *SS. Mormaclynx*, —— F.2d ——, —— - —— (2 Cir. 1971), slip op. 247, 258-62 (October 29, 1971).

With respect to the merits of the state law claim, the District Court, rejecting Ryan's contention that the options when exercised were invalid because their underlying purpose—employee ownership of the stock—was no longer required by JWT corporate policy, held under New York law that, regardless of the corporate policy underlying the option agreement, such agreement would be invalid only if it prevented transfer of the stock, as opposed to merely delaying transfer, as here, by giving the corporation a right of first refusal. We agree. *Allen* v. *Biltmore Tissue Corp.*, 2 N.Y. 2d 534, 161 N.Y.S. 2d 418, 141 N.E. 2d 812 (1957); *Penthouse Properties, Inc.* v. *1158 Fifth Avenue, Inc.*, 256 App. Div. 685, 11 N.Y.S. 2d 417 (1st Dept. 1939). See also *Rafe* v. *Hi[illegible]* App. Div. 2d 481, 288 N.Y.S. 2d 662 (2d Dept. 1[illegible] *aff'd*, 23 N.Y. 2d 759, 296 N.Y.S. 2d 955, 244 N.E. 2d 4[illegible] (1968); *Martin* v. *Graybar Electric Co.*, 285 F.2d 619 (7 Cir. 1961).

With respect to the Rule 10b-5 claim, the District Court held that, since Ryan was obligated to sell his shares to

JWT in January 1969, whatever he knew or did not know regarding JWT's plans to go public was irrelevant. We agree. See *Fershtman* v. *Schectman*, —— F.2d ——, —— (2 Cir. 1971), slip op. 325, 330 (November 3, 1971). Ryan's reliance upon *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2 Cir. 1968) (*en banc, cert. denied*, 394 U.S. 976 (1969), is misplaced. Even under the broadest interpretation of the language of *Texas Gulf Sulphur*, Rule 10b-5 does not spread a comfortable canopy to keep Ryan out of the inclement weather.

In short, we affirm upon the well reasoned opinion of Judge Wyatt below. 322 F. Supp. 307 (S.D.N.Y. 1971).

Affirmed.

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Supreme Court of the United States

OCTOBER TERM 1971

Docket No. 71-1197

O'NEILL RYAN and UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee of a Trust dated April 15, 1968 for the benefit of Sara Ryan Hill,

Petitioners,

against

J. WALTER THOMPSON, COMPANY,

Respondent.

SUPPLEMENTAL APPENDIX TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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March 17, 1972

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Appendix B

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Docket No. 71-1358

—o—

O'NEILL RYAN and UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee of a Trust dated April 15, 1968 for the Benefit of Sara Ryan Hill,

Plaintiffs-Appellants,

against

J. WALTER THOMPSON COMPANY,

Defendant-Appellee.

—o—

A petition for a rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the appellants and no active circuit judge having requested that a vote be taken on said suggestion,

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

HENRY J. FRIENDLY
Chief Judge.

December 20, 1971

Appendix C

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Cal. No. 67—September Term, 1971

Docket No. 71-1358

O'NEILL RYAN and UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee of a Trust dated April 15, 1968 for the Benefit of Sara Ryan Hill,

Plaintiffs-Appellants,

against

J. WALTER THOMPSON COMPANY,

Defendant-Appellee.

Order

A petition for rehearing *en banc* having been filed herein on December 2, 1971 by counsel for appellants; and

Due consideration by the undersigned members of the panel having been given to said petition for rehearing; and

Due consideration also having been given to a letter dated November 18, 1971, from Leo T. Kissam, Esq., one of the attorneys for appellants, addressed to the undersigned members of the panel, requesting that a certain correction be made in the Court's *per curiam* opinion filed herein on November 18, 1971; it is therefore

ORDERED that the said petition for rehearing be, and the same hereby is, denied; and it is further

ORDERED, in response to the said letter from Leo T. Kissam, Esq., that the following correction be made in the Court's opinion of November 18, 1971:

Appendix C

Slip opinion, page 606, lines 13-17

Change the second sentence of this paragraph and the citation to read:

"Although the parties on appeal have addressed themselves to this issue, we nevertheless have examined the record ourselves. Cf. *Gem Corrugated Box Corp.* v. *National Kraft Container Corp.*, 427 F.2d 499, 501 n. 1 (2 Cir. 1970), and cases there cited."

Dated at New York, N. Y. this 20th day of December, 1971.

STERRY R. WATERMAN
STERRY R. WATERMAN
United States Circuit Judge

J. JOSEPH SMITH
J. JOSEPH SMITH
United States Circuit Judge

WILLIAM H. TIMBERS
WILLIAM H. TIMBERS
United States Circuit Judge

Appendix D

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

69 Civ. 2249

O'NEILL RYAN and UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee of a Trust dated April 15, 1968 for the benefit of Sara Ryan Hill,

Plaintiffs,

against

J. WALTER THOMPSON COMPANY,

Defendant,

Appearances:

KISSAM & HALPIN, ESQS., Attorneys for Plaintiffs, 120 Broadway, New York, New York 10005.

LEO T. KISSAM, ESQ., ANTHONY S. GENOVESE, ESQ., ROBERT A. WARREN, ESQ., MICHAEL F. FITZGERALD, ESQ., of Counsel.

BREED, ABBOTT & MORGAN, ESQS., Attorneys for Defendant, 1 Chase Manhattan Plaza, New York, New York 10005.

EDWARD J. ROSS, ESQ., MIRIAM C. FEIGELSON, of Counsel.

These are motions for summary judgment, the first in time by defendant and the other by plaintiffs. Fed. R. Civ. P. 56. All parties agree that there is no genuine issue as to any material fact and that summary judgment is appropriate. Each side insists that summary judgment

must be for it. The conclusion reached is that defendant is entitled to summary judgment.

The action is brought under Section 10(b) of the Securities Exchange Act of 1934 ("the Act"; 15 U.S.C. § 78j) and Rule 10b-5 thereunder. Jurisdiction is claimed under Section 27 of the Act (15 U.S.C. § 78aa) and "the doctrine of pendent jurisdiction". There is no claim to diversity jurisdiction and apparently there is none in fact, plaintiffs being citizens of New York and defendant, whether treated as a New York or a Delaware corporation, has its principal place of business in New York (28 U.S.C. § 1332(c)).

The complaint in one count asks for rescission of a sale of stock by plaintiffs to defendant. The sale was made on the exercise by defendant of an option which the complaint avers was unenforceable at the time of its exercise. The complaint also avers that defendant, as purchaser, failed to disclose a material fact to plaintiffs (a contemplated public offering of Thompson stock) and that had plaintiffs known such fact they would not have made the sale.

The facts are as follows:

J. Walter Thompson Company was founded in 1864 and was incorporated in New York in 1907. At all relevant times it was the largest advertising agency in the world.

This action was commenced on May 26, 1969, defendant being described as a New York corporation, which it then was. The New York corporation, however, after March 1969 had a wholly owned subsidiary, a Delaware corporation. For reasons which will later appear, the New York corporation on June 12, 1969 was merged into its Delaware subsidiary which was the surviving corporation.

When the answer was served and filed on July 16, 1969, the answering defendant described itself as a Delaware corporation and recited the corporate events mentioned. These do not appear to be of significance here. "Thompson" will be used to refer to defendant and to its predecessor.

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Plaintiff Ryan was employed by Thompson in three different periods: from 1932 through 1936; again from 1941 through 1950; and again from 1954 until January 31, 1966 when he retired for age.

Thompson had a fixed policy that the business should be owned by those who were active workers in its employ. From time to time, therefore, Thompson made available shares of its capital stock to its officers and other employees. If its policy were to be effective, Thompson had to be able to buy back its stock whenever any holder desired to sell or ceased to be an employee. Accordingly, when its shares were sold, Thompson reserved an option to repurchase; it was the fixed policy to exercise all such options in aid of the primary policy that Thompson should be wholly owned by its employees.

Ryan bought no stock in his first employment period. He did buy stock in his second employment period. He resigned from his employment on September 18, 1950 and shortly thereafter Thompson, exercising its option, repurchased his stock.

Ryan returned to the employment of Thompson in 1954. Ryan purchased capital stock from Thompson in 1956, 1957, 1960 and 1963. The purchase price, according to the practice of Thompson, was net asset value excluding any value for good will.

Effective December 31, 1964, Thompson had a retirement age of 65 for all employees.

As already noted, the shares owned by Ryan (and all other shares) were subject to an option in Thompson to repurchase in certain events. The terms of the option were expressed in the certificate of incorporation of Thompson. Among other events, Thompson had an option to repurchase the stock when Ryan ceased to be a director, officer or employee of Thompson by reason of his retirement. This option could be exercised between January 1 and March 31

of the third year after the year in which retirement occurred. The option price was specified and for common stock was the net asset value, excluding any value for good will. It was specifically provided that "in all cases" the decision whether to exercise an option was to be made by the board of directors of Thompson.

After the last purchase of shares by Ryan in 1963, he and the other directors and (apparently) the other employees executed written option agreements. The option agreement executed by Ryan was under date of June 27, 1963. The purpose and effect of this agreement was to vary (among other things, by lengthening) the option period if a stockholder ceased to be a director, officer or employee *before* retirement age.

Ryan became 65 years old during the year 1963 and was therefore scheduled to retire on December 31, 1964. Thompson elected, however, to continue his employment for another year. Before December 31, 1965, it appeared that Ryan required an operation and to give him certain medical benefits available to Thompson employees, the date of retirement was made January 31, 1966. This was done by written agreement under date of December 1, 1965 (signed by Ryan on December 2, 1965). This agreement provided, however, that the option period to Thompson should be the same as if Ryan had retired on December 31, 1965.

Ryan did in fact retire on January 31, 1966. At that time he owned 500 shares of Class A common stock and 1,500 shares of Class B common stock of Thompson. The option to Thompson was exercisable between January 1 and March 31, 1968.

There was a recapitalization of Thompson in April 1966 and a stock dividend in March 1967. As a result of these events, after March 1967 Ryan owned—subject to the option—2,000 shares of 6% preferred stock, 1,000 shares of Class A common stock, and 4,000 shares of Class B common stock of Thompson. Ryan had paid for this stock

$83,686 (according to his counsel) or $93,492.23 (according to counsel for Thompson). It is not necessary to determine the exact figure. Whatever it was, nothing was paid for good will as an element of the purchase price.

In October 1967, there was an agreement between Thompson and Ryan—apparently oral—under which the option period to Thompson was postponed for one year to January 1-March 31, 1969. This is said for Thompson to have been at the "urging" of Ryan. In any event, the postponement was a financial benefit to Ryan because, during the additional year he was permitted to retain his shares, the net asset value (and thus option price) of his common shares increased by $9 per share and there were dividends of $7,150.

In April 1968, Ryan transferred to plaintiff United States Trust Company in trust for his daughter 2,000 shares of 6% preferred stock and 2,250 shares of Class B common stock of Thompson. This is said by Ryan to have been "with the consent of Thompson". Ryan continued to own 1,000 shares of Class A common stock and 1,750 shares of Class B common stock of Thompson. The transfer in trust is of no significance here and all of the stock will be treated as owned by Ryan himself.

In August 1968, Thompson had need of additional working capital and considered in this connection a sale to the public of shares of its stock (sometimes called "going public" or to "go public"). In that month, Thompson began consultations with investment bankers. The sale of stock to the public would mean a significant change in the policy of Thompson to that time.

In October 1968, the investment bankers recommended that shares of Thompson be sold to the public.

By early to middle November 1968, the Thompson management must have reached a decision to sell shares to the public, subject to certain eventualities. One of the most

important of these was that the principal clients, when advised, expressed no strong objections.

Having made this decision, Thompson sought an opinion from counsel whether the options maturing in 1969 (such as that in respect of Ryan's stock) should be exercised. Under date of November 13, 1968, counsel advised that, for reasons given, all such options should be exercised.

Under date of January 14, 1969, Thompson notified Ryan that, by decision of the Executive Committee made on the same date, it exercised the option to repurchase his stock. The option price of the preferred stock was par value or $25 per share; the option price of the common stock (both classes) was $45.24 per share.

Ryan appeared to accept the exercise of the option as normal and reasonable. He wrote to an officer of Thompson that the $45.24 price was "gratifying" and indicated a knowledge of the possibility that Thompson would change its policy and have public stockholders: "if and when JWT goes public I surmise this same asset value, plus mark up for the earnings 'intangibles' would command about $125 . . .".

The sale to Thompson was completed in January of 1969 and Ryan received for his stock $276,200 (less a small amount for transfer stamps). Ryan was not advised by Thompson at any time prior to the repurchase of his shares that a public offering was in contemplation.

Talks with the principal clients of Thompson took place in January, February and March 1969 and apparently there was no strong objection to the plan of Thompson to go public.

On March 28, 1969, Thompson filed with the Securities and Exchange Commission a printed form of Registration Statement covering a proposed public offering of shares. On the same date, the president of Thompson advised Ryan of the decision to make a public offering.

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On April 10, 1969, Thompson sent out notices of a special meeting of shareholders to consider and act on matters connected with the proposed public offering, principally the plan of merger of the New York corporation into its subsidiary Delaware corporation (recently organized for the purpose).

The meeting of shareholders on May 5, 1969 gave the necessary approvals.

As noted much earlier, the case at bar was commenced on May 27, 1969.

The recapitalization took place as authorized and on June 4, 1969 the public offering was made.

Before the recapitalization, Thompson had exercised all options to repurchase which were capable of being exercised, that is, which had then matured.

As part of the recapitalization, all stock at that time subject to an option in Thompson to repurchase in the future—that is, an option not yet matured for exercise by Thompson—was converted into shares of new common stock and new common stock—Class B. Each share of old preferred stock was converted into one share of new common stock; each share of old Class A common stock was converted into five shares of new common stock; each share of old Class B common stock was converted into one share of new common stock and four shares of new common stock—Class B.

The new common stock was free of any option to Thompson. The new common stock—Class B was subject to an option to Thompson to repurchase, but 25% of such stock was to be automatically changed share for share to common stock (free of option) on June 12 of each year, 1970 through 1973. Moreover, if the holder of new common stock—Class B died, became disabled, or left the employ of Thompson after reaching retirement age all his shares of new common stock—Class B were to be auto-

matically changed share for share to common stock (free of option).

The recapitalization therefore eliminated the option to Thompson, to the extent and under the conditions described, on shares of old stock held at the time of recapitalization by the following:

a. the then officers, directors and employees of Thompson, and

b. any officer, director, or employee who had retired after reaching retirement age and whose retirement occurred after December 31, 1966.

The effect of the recapitalization, certainly well understood in advance, was to add the value of good will to the value of all shares as to which the option to Thompson was eliminated.

Another effect of the recapitalization, doubtless also well understood in advance, was to enable the then officers, directors and employees of Thompson (as well as the others just mentioned above) to sell as part of the public offering a substantial number of shares of new common stock and at a value reflecting the increment of good will.

The public offering on June 4, 1969 was of 790,000 shares of new common stock at $38 per share. The shares offered and sold represented about 27% of the outstanding shares of Thompson.

Thompson itself sold 350,000 shares. The underwriting discounts and commissions were $2.05 per share. Thompson (with approval of its stockholders) paid all the expenses of the offering. The proceeds of the offering received by Thompson (after deducting estimated expenses) were $12,281,500.

The J. Walter Thompson Company Profit-Sharing Trust sold 109,709 shares, paid no expenses, and received as proceeds $35.95 per share or a total of $11,873,961.45.

The directors and senior officers held the largest number of shares and received the largest proceeds.

The selling individual stockholders were principally the then officers, directors and employees of Thompson together with those former employees who had retired (after reaching retirement age) after December 31, 1966. It is evident that as to them the recapitalization of Thompson and the public offering produced a windfall.

The disappointment to Ryan was entirely natural. The accidents of timing made the situation all the more painful. Had he been a director and officer at June 4, 1969, or had he retired after instead of during 1966, his holdings of Thompson stock would have had a realizable value far in excess of what he received on exercise of the repurchase option in January 1969.

Had Ryan been able to retain his old shares, in recapitalization these would have been converted into 27,000 new common shares which, at the $35.95 per share price received by the selling individual stockholders on the public offering, would have had a value on June 4, 1969 of $970,650. This figure may be contrasted with the $276,200 received by Ryan in January 1969.

In appraising this situation, however, it must be remembered that the enforcement of a fixed "cut off" date or of a fixed line of distinction frequently produces results which may be described as in some ways harsh. Moreover and aside from the advice of its counsel, Thompson as a practical matter could not have waived the exercise of its option to repurchase Ryan's stock. If it waived as to Ryan, it would in fairness be required to waive as to all those who retired in 1966. If these options were not exercised by March 31, 1969, the optioned stock would thereafter be free of the option and could be sold to anyone. This result would itself change or seriously affect the long standing practice of Thompson, at a time when there was no assurance that there would be a successful public offering.

Thompson had no such assurance until June 4, 1969 when the Underwriting Agreement was executed (the prospectus states that it was so "dated" and its execution on that date is assumed). The underwriters were not bound to take and pay for the new shares until execution of the underwriting agreement. Thompson made it perfectly plain in the material sent to its stockholders that the recapitalization would not take place "if the shares of stock of the Delaware Company are not delivered to and paid for by the Underwriters . . .". If the public offering were not made, Thompson had only the alternative of continuing, at least for some period, under an employee ownership policy as before. This alternative would have been sacrificed or gravely compromised if there had been a failure by Thompson to exercise all matured options to purchase before March 31, 1969, in the case of Ryan and all those similarly situated. Thompson was obliged to exercise the options before March 31, 1969 to guard itself against the possibility of a failure of the public offering thereafter. Thus, the business judgment of the Thompson management was not unfairly or unreasonably exercised. Whether the options were valid as a matter of law is another question.

The Validity of the Thompson Option did not Depend Upon the Existence of a Policy That all Stock of Thompson be Owned by its Employees

The necessary contention for plaintiffs is that the option to Thompson can only be valid so long as the policy of Thompson is to require ownership of its shares only by employees (or for a limited period by former employees). This contention is without merit and, being rejected, judgment for defendant must follow.

We may start with the proposition that the option has at all relevant times been part of the certificate of incorporation, referred to on the stock certificates, and known

to Ryan when he bought his shares. It is thus a matter of contract between Ryan and Thompson. Why should it not be enforced? Only if against public policy would seem to be the answer.

There is a general public policy against restraints on the transfer of personal property but, at least in recent years, this has not affected the validity of an option to the corporation to buy its shares before a stockholder may sell to another.

It must be emphasized that such an option does not prevent a transfer, nor does it condition a transfer on any consent. The option merely delays a transfer for a period within which the corporation may buy its shares. If the corporation does not buy, there are no restrictions on transfer.

The early decisions which sustained such a "first option" did not do so because it kept ownership in those *employed* by the corporation but because it gave a measure of control to those who *owned* the corporation. For example, in *Doss* v. *Yingling*, 95 Ind. App. 494, 500, 172 N.E. 801, 803 (Appellate Court of Indiana, en banc, 1930) it was said:

> "The regulation imposed on the alienation of the common capital stock in this corporation was a reasonable one. It does not prevent the alienation of the stock; no permanent impediment to the transfer is contemplated by the terms of the agreement and by-law. The only purpose was to give to those owning stock the right and privilege to keep the control of the corporation in the hands of those who are its friends and friendly to those intrusted with the administration of its prudential affairs. The restrictions in this instance are not against public policy."

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Such a first option was sustained in New York in *Coules* v. *Coules Realty Co.*, 201 App. Div. 460, 194 N.Y.S. 546 (1st Dept. 1922) and *Hassel* v. *Pohle*, 214 App. Div. 654, 212 N.Y.S. 561 (2d Dept. 1925).

Then came a reference in New York to the principle that it is against public policy to restrain the transfer of shares of stock, followed by this flat statement (*Penthouse Properties* v. *1158 Fifth Avenue*, 256 App. Div. 669, 11 N.Y.S.2d 416, 422 (1st Dept. 1939)):

> "But restrictions against the sale of shares of stock, unless other stockholders or the corporation have first been accorded an opportunity to buy, are not repugnant to that principle".

More recently came the controlling decision in New York, *Allen* v. *Biltmore Tissue Corp.*, 2 N.Y.2d 534, 161 N.Y.S.2d 418 (1957). There was a 60 day option to the corporation to repurchase its stock before the stock could be sold to others. The option price was the price paid by the stockholder on issuance. The option was in the by-laws. The stock was originally issued, not to employees only, but to others as well. The option was sustained by a unanimous Court of Appeals. Judge (now Chief Judge) Fuld said (emphasis in original):

> "The courts have almost uniformly held valid and enforcible the first option provision, in charter or by-law, whereby a shareholder desirous of selling his stock is required to afford the corporation, his fellow stockholders or both an opportunity to buy it before he is free to offer it to outsiders. . . . The courts have often said that this first option provision is 'in the nature of a contract' between the corporation and its stockholders and, as such, binding upon them. . . .

Appendix I)

> "As the cases thus make clear, what the law condemns is, not a *restriction* on transfer, a provision merely postponing sale during the option period, but an effective *prohibition* against transferability itself."

It is important to note that the first option in and of itself is held to be reasonable, this because it does not prevent transfer but merely delays transfer. There is no suggestion that some other purpose or object must justify the option, much less that this purpose or object be employee ownership. Indeed, in the cited case, the litigant stockholder had never been an employee of the corporation.

True, Judge Fuld says that "generally speaking" the first option restriction is employed by the "close corporation" but it is clear that this is merely by way of description or illustration and not by way limitation. Moreover, the expression "close corporation" is not used to refer to a corporation wholly owned by its employees but rather to a corporation owned by a small group.

Under the New York decisions, therefore, the first option to Thompson was valid whatever may have been the policy of Thompson in January 1969.

Ryan was therefore obligated to sell his shares to Thompson in January 1969. Whatever he knew or did not know made no difference in what he was required to do. There can be no possible claim under Section 10(b) and Rule 10b-5 in such circumstances. See *Lawrence* v. *Sudman*, 70 F.Supp. 387, 396 (S.D.N.Y. 1945).

There Had Been No Change in the Policy of Thompson in January 1969

The contention for plaintiffs is that when the option was exercised in January 1969 Thompson had already decided to go public and thus had changed the policy on which the validity of the option depended.

Assuming that such a change in policy would affect the validity of the option, no such change had in fact occurred in January 1969.

It seems clear that Thompson did not change its policy of 100% ownership by employees until June 4, 1969, when the underwriting agreement was signed. It planned to change its policy, expected to change its policy, took steps to change its policy in and before January 1969 but did not in fact change its policy and could not be sure that it would change its policy until June 4, 1969. The reason, as already noted, was that if for any reason the public offering could not be accomplished, Thompson had to be able to continue its then policy of 100% employee ownership; it would be forced to turn to means for raising working capital other than by sale of stock to the public.

When the option was exercised in respect of the stock of Ryan, Thompson was 100% employee owned and might so remain indefinitely.

THE OTHER QUESTIONS NEED NOT BE DETERMINED

There are a number of other issues, such as, for example, whether Ryan had knowledge, when the option was exercised, that Thompson was planning to go public. These issues, while interesting, need not be determined because in the view taken, that the option was valid in January 1969, they do not affect the result.

The view taken additionally involves dismissal of the counterclaim as without merit.

There is no genuine issue as to any material fact and defendant is entitled to judgment as a matter of law. Fed. R. Civ. P. 56 (c). The Clerk is directed to enter judgment for defendant dismissing the action and for plaintiffs dismissing the counterclaim.

SO ORDERED.

Dated: New York, New York, January 29, 1971.

INZER B. WYATT
United States District Judge

Appendix E

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

69 Civil 2249

O'NEILL RYAN and UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee of a Trust dated April 15, 1968 for the Benefit of Sara Ryan Hill,

Plaintiffs,

against

J. WALTER THOMPSON COMPANY,

Defendant.

The plaintiffs and defendant having moved the Court for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure, and the said motions having come on to be heard before the Honorable Inzer B. Wyatt, United States District Judge, and the Court thereafter on January 29, 1971, having handed down its opinion directing the Clerk to enter judgment for the defendant dismissing the action and for plaintiffs dismissing the counterclaim, it is,

ORDERED, ADJUDGED and DECREED: That the defendant J. Walter Thompson Company have judgment against the plaintiffs, O'Neill Ryan and United States Trust Company of New York, as Trustee of a Trust dated April 15, 1968 for the benefit of Sara Ryan Hill, dismissing the complaint, and it is further,

ORDERED, ADJUDGED and DECREED: That plaintiffs O'Neill Ryan and United States Trust Company of New York, as Trustee of a Trust dated April 15, 1968, for the benefit of Sara Ryan Hill have judgment against the defendant J. Walter Thompson Company, dismissing the counterclaim.

Dated: New York, N. Y.
February 1, 1971

JOHN LIVINGSTON
Clerk

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IN THE

Supreme Court of the United States

October Term 1971

Docket No. 71-1197

O'NEILL RYAN and UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee of a Trust dated April 15, 1968 for the benefit of Sara Ryan Hill,

Petitioners,

against

J. WALTER THOMPSON COMPANY,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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March 31, 1972

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IN THE

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O'NEILL RYAN and UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee of a Trust dated April 15, 1968 for the benefit of Sara Ryan Hill,

Petitioners,

against

J. WALTER THOMPSON COMPANY,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The petition seeks grant of certiorari on two grounds, namely, that the Court of Appeals decided an important state question in conflict with applicable state law, and that it has decided an important question of federal law which has not been, but should be, settled by this Court (Rule 19, 1(b)).

Summary of Reasons for Denying Certiorari

The petition, which does not state "special and important" reasons for this Court to grant the writ, should be denied for the following reasons:

(1) This Court will "not review, save in exceptional cases, the considered determination of questions of state law by the intermediate federal appellate courts." *Huddleston* v. *Dwyer,* 322 U.S. 232, 237 (1944); *Estate of Spiegel* v. *Commissioner,* 335 U.S. 701, 707-8 (1949).

(2) The Court of Appeals decided the issue in precise accord with state law, as reflected in *Allen* v. *Biltmore Tissue Corporation,* 2 N.Y.2d 534 (1957).

(3) The decision below,—which is merely a holding that the disclosure provisions of SEC Rule 10b-5 have no application to sale of stock under a pre-existing option contract, because, regardless of what may or may not be disclosed, the seller is already contractually obligated to sell, —does not involve an important question of federal law.

(4) The issue does not involve any principle of public or far-reaching importance, and it has no significance beyond this particular case.

(5) Petitioners' position is based on a special fact situation and the construction of particular option provisions in Respondent's certificate of incorporation, and certiorari is not granted to review evidence, discuss specific facts, or review the construction of particular contracts or written instruments (*United States* v. *Johnston,* 268 U.S. 220, 227 (1925)).

The Opinions Below

The Court of Appeals' *per curiam* opinion relied on "the District Court's clear, comprehensive and detailed statement of the facts" (A. 3), and affirmed upon its "well reasoned opinion" (A. 5). Accordingly, review of the Court of Appeals' opinion necessarily involves review of the District Court's opinion. This was belatedly recognized by Petitioners, who did not include the District Court's opinion in their original petition, necessitating a Supplemental Appendix (A. 10-23).

Questions Presented

(1) Does a provision in the certificate of incorporation of a 100% employee-owned New York corporation, which requires a retired shareholder-employee to afford the corporation a first 90-day option to buy the stock, at a formula price, in order to maintain employee-ownership, become invalid under New York law because, months after the option was exercised and the stock sold, the corporation ceased to be 100% employee-owned and became 27% publicly-owned and 73% employee-owned?

(2) Can a former stockholder of a 100% employee-owned New York corporation, who sold his stock to the corporation on its exercise of an option, rescind the sale under SEC Rule 10b-5, on the ground that when the sale was made, the corporation did not disclose to the seller that it was planning and taking steps to offer shares to the public, and thereby become 73% employee-owned, instead of 100% employee-owned?

Statement of the Case

Petitioner Ryan, a former employee of Respondent J. Walter Thompson Company ("Thompson"), "the largest advertising agency in the world" (A. 11) and previously 100% employee-owned, bought Thompson stock from time to time at a formula price of net asset value, exclusive of good will. All Thompson stock was sold to employees subject to a 90-day first option in Thompson to repurchase in certain events, which included the employee's retirement, termination of employment before retirement or proposed sale to a third party. The option price was based on the same formula as the sales price to the employee, namely, net asset value, exclusive of good will.

Ryan, aware of the option and its full implications, testified that the option was "gospel," and that he knew of his obligation to resell on retirement "just like I knew my name was Ryan and I was working for J. Walter Thompson" (R. 39, pp. 41, 84-5). The option, as the District Court stated, was "a matter of contract between Ryan and Thompson" (A. 20).

Ryan paid $83,686 for his stock and, because of increase in net asset value, received $276,200 from Thompson on the repurchase, with a $192,514 profit, apart from dividends, —a price he described as "gratifying" (A. 15).

Because Thompson's substantial good will was not reflected in the price of net asset value, at which stock was sold to employees, and because the stock was subject to repurchase at net asset value, Ryan always bought well

below the stock's value, if good will were included. He now seeks to rescind his sale to Thompson, because, despite his substantial profit, the stock would have been worth more than the option price, if the option could be deemed invalid and the stock could be valued with inclusion of good will.

Ryan sold his stock to Thompson on January 14, 1969. On June 4, 1969, Thompson made a public offering of 27% of its stock, which resulted in its becoming 73%, rather than 100%, employee-owned.

In January 1969, when Ryan sold his stock, Thompson was seriously considering the public offering, but its decision was awaiting clearance with principal clients to ascertain whether any would object to public ownership. Thompson sought to maintain confidentiality, so that its clients would not first hear of the possible public offering from outside sources. After clearance with all Thompson's principal clients, which "took place in January, February and March 1969" (A. 15), the proposed offering was publicly announced on March 28, 1969 (A. 15), over two months after Ryan had sold his stock. The offering was made on June 4, 1969, over four months after Ryan's sale.

However, until the actual public offering on June 4, 1969, there was no certainty it would be made. This was recognized by Ryan's counsel, whose affidavit in support of summary judgment stated that Ryan made no claim that before he had sold his stock under the option, "Thompson made a final and irrevocable commitment to 'go public'" (App. below, p. 85a). The District Court held that Thompson had "no assurance that there would be a successful

public offering until June 4, 1969 when the Underwriting Agreement was executed" (A. 18-19).

It is Ryan's position that had he known Thompson was planning a public offering, he would have treated the option as invalid under state law and would have refused to sell, and that Thompson's failure, in January 1969, when the option was exercised, to disclose its plans for a public offering violated SEC Rule 10b-5.

Parenthetically, the evidence established that Ryan really knew of the possible public offering. For in delivering his stock to Thompson, he not only described the option price of $45.24 a share as "gratifying", but stated that "if and when JWT goes public I surmise this same asset value, plus mark up for the earnings 'intangibles' would command about $125". (A. 15). This prompted the District Court to refer to the issue, which it found unnecessary to decide, that "Ryan had knowledge, when the option was exercised, that Thompson was planning to go public" (A. 23).

I

This Court will not normally review questions of state law determined by intermediate federal appellate courts.

Both courts below applied state law as to the validity of a 90-day first option in a corporation to repurchase its stock, as reflected in *Allen* v. *Biltmore Tissue Corporation,* 2 N.Y.2d 534 (1957). The District Court, describing this case as "the controlling decision in New York" (A.

21), concluded that "Under the New York decisions, therefore, the first option to Thompson was valid whatever may have been the policy of Thompson in January 1969" (A. 22).

The Court of Appeals, also relying on *Allen* as controlling, agreed that under New York law an option "giving the corporation a right of first refusal" is valid (A. 4).

Clearly, this is not one of the "exceptional cases" where this Court will review "the considered determination of questions of state law by the intermediate federal appellate courts." *Huddleston* v. *Dwyer, supra.*

II

The Court of Appeals and District Court correctly applied state law.

(1) *Allen* v. *Biltmore Tissue Corporation,* 2 N.Y.2d 534 (1957), sustained a first option, having marked similarity to the Thompson option, except that in *Allen* the option price was identical with the price at which the stock was originally sold to the stockholder, whereas Ryan bought for $83,686 and sold for $276,200.

In *Allen,* the Court of Appeals stated (p. 541):

> "The question posed, therefore, is whether the provision, according the corporation a right or first option to purchase the stock at the price which it originally received for it, amounts to an unreasonable restraint. In our judgment, it does not.

"The courts have almost uniformly held valid and enforcible the first option provision, in charter or by-law, whereby a shareholder desirous of selling his stock is required to afford the corporation, his fellow stockholders or both an opportunity to buy it before he is free to offer it to outsiders. (See, e.g., *Penthouse Properties* v. *1158 Fifth Ave., supra,* 256 App. Div. 685; *Hassel* v. *Pohle,* 214 App. Div. 654; *Cowles* v. *Cowles Realty Co.,* 201 App. Div. 460; *Palmer* v. *Chamberlin,* 191 F. 2d 532; *Doss* v. *Yingling,* 95 Ind. App. 494; *Baumohl* v. *Goldstein,* 95 N. J. Eq. 597; see, also, 8 Fletcher, *op. cit.,* §4205, p. 787). The courts have often said that this first option provision is 'in the nature of a contract' between the corporation and its stockholders and, as such, binding upon them. (*Hassel* v. *Pohle, supra,* 214 App. Div. 654, 658; see, also 8 Fletcher, *op. cit.* §4194, p. 736.)"

The Court of Appeals further stated (p. 542):

"As the cases thus make clear, what the law condemns is, not a *restriction* on transfer, a provision merely postponing sale during the option period, but an effective *prohibition* against transferability itself. Accordingly, if the by-law under consideration were to be construed as rendering the sale of the stock impossible to anyone except to the corporation at whatever price it wished to pay, we would, of course, strike it down as illegal. But that is not the meaning of the provision before us. The corporation had its option only for a 90-day period." (Italics the court's.)

Here, the District Court, in referring to the Thompson option and applying the *Allen* case, stated (A. 20):

"It must be emphasized that such an option does not prevent a transfer, nor does it condition a transfer on any consent. The option merely delays a trans-

> fer for a period within which the corporation may buy its shares. If the corporation does not buy, there are no restrictions on transfer."

The Court of Appeals, also citing the *Allen* case, stated that "regardless of the corporate policy underlying the option agreement, such agreement would be invalid only if it prevented transfer of the stock, as opposed to merely delaying transfer, as here, by giving the corporation a right of first refusal" (A. 4).

As already noted, *Allen* held that a restriction on transfer would be invalidated only where it rendered sale of the stock "impossible to anyone except to the corporation at whatever price it wished to pay." This is not the case here, where Thompson merely had a 90-day option; where the option price was fixed in the option agreement; and where Ryan obtained a $192,514 profit on an $83,686 investment.

(2) The *Allen* decision, which represents New York law, had previously been followed in both the Second and Seventh Circuits, when they had occasion to consider the validity of such options under New York law.

Thus, *Globe Slicing Machine Co.* v. *Hasner,* 333 F.2d 413, 415 (2d Cir. 1964), states:

> "Under New York law first option provisions restricting alienation of stock through testamentary as well as *inter vivos* transfers are valid. Allen v. Biltmore Tissue Corp., 2 N.Y.2d 534."

In *Martin* v. *Graybar Electric Co.,* 285 F.2d 619 (7th Cir. 1961), which also involved a 100% employee-owned

New York corporation, the plaintiff-employee had bought his stock at $20 a share and had granted the corporation "an option to purchase his stock at $20.00 a share, on cessation of employment" (p. 622). The Seventh Circuit also found the *Allen* case controlling as to validity of a New York corporation's option to purchase its employees' stock on termination of employment (p. 625).

The *Allen* case, which represents the law of New York, was properly applied by both courts below.

(3) The petition fails to point to any contrary state appellate court decision. The only New York case relied on in the petition (pp. 9-10) where an option was not enforced, is *Matter of Sands Point Land* v. *Rossmore*, 43 Misc.2d 368 (Sup. Ct. Nass. Co. 1964). That case, however, did not hold the option invalid, but merely held that an option to buy was not intended to apply to "the *dissolution* of a corporation, as distinguished from a *sale*" (p. 372; italics the court's). But even were this case in conflict with the decision below, failure of a federal intermediate appellate court to follow a decision of a *nisi prius* court at Special Term, which is not even binding on other New York courts, does not warrant grant of certiorari. *King* v. *Order of Travelers*, 333 U.S. 153, 161 (1948)).

(4) Finally, even if a change in Thompson's policy from 100% employee-ownership to 73% employee-ownership could, under New York law, have rendered the option invalid, the change had not been made when Ryan sold his stock in January 1969, but was made months later. A change in policy made June 1969 could not affect validity of an option exercised four months previously. As to this

fact, which alone is a conclusive bar to Ryan's claim, the District Court stated (A. 23):

> "Assuming that such a change in policy would affect the validity of the option, no such change had in fact occurred in January 1969.
>
> "It seems clear that Thompson did not change its policy of 100% ownership by employees until June 4, 1969, when the underwriting agreement was signed. It planned to change its policy, expected to change its policy, took steps to change its policy in and before January 1969 but did not in fact change its policy and could not be sure that it would change its policy until June 4, 1969. The reason, as already noted, was that if for any reason the public offering could not be accomplished, Thompson had to be able to continue its then policy of 100% employee ownership; it would be forced to turn to means for raising working capital other than by sale of stock to the public.
>
> "When the option was exercised in respect of the stock of Ryan, Thompson was 100% employee owned and might so remain indefinitely."

Since the petition is premised on the contention that the court below decided an important state question in a way which is in conflict with applicable state law, whereas in fact the court below clearly followed applicable state law, there can be no basis for granting the writ.

III

The case does not involve an important question of federal law.

The petition also claims that the Court of Appeals decided an important question of federal law which has not been, but should be, settled by this Court; and asks this Court "to clarify the disclosure requirements mandated by Section 10(b) * * * and the SEC Rule 10b-5" (p. 1). As the court below stated at the outset, the petitioner has invoked "the salutary anti-fraud provisions of the federal securities laws" in a case "where those provisions are wholly inappropriate and wide of the Congressional mark" (A. 2). It also described the federal securities law claim as "misplaced", and stated that petitioner was merely asserting "a state law claim that, but for the federal gloss, should have been litigated in the state courts" (A. 2).

Rule 10b-5 does not apply to a sale made under a pre-existing option. The Rule's purpose is to provide "equalization of bargaining position" by enabling outsiders to "exercise an informed judgment". *Speed* v. *Transamerica Corp.*, 99 F.Supp. 808, 829 (D.Del. 1951), *aff'd*, 235 F.2d 369 (3d Cir. 1956). As stated in *List* v. *Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir. 1965), the Rule requires disclosure of information which would have affected a seller's judgment "so as to put the seller in an equal bargaining position with the buyer". However, where the seller has no judgment to exercise and is not in a position to bargain, because already contractually bound under an option to sell, Rule 10b-5 has no application.

Accordingly, the District Court held (A. 22):

> "Ryan was therefore obligated to sell his shares to Thompson in January 1969. Whatever he knew or did not know made no difference in what he was required to do. There can be no possible claim under Section 10(b) and Rule 10b-5 in such circumstances. See *Lawrence* v. *Sudman,* 70 F.Supp. 387, 396 (S.D. N.Y. 1945)."

The Court of Appeals, in considering the Rule 10b-5 claim, agreed that "since Ryan was obligated to sell his shares to JWT in January 1969, whatever he knew or did not know regarding JWT's plans to go public was irrelevant" (A. 4-5).

The issue whether Rule 10b-5 applies to sales by persons already contractually obligated to sell under a valid pre-existing option is not "an important question of federal law."

Conclusion

The petition for a writ of certiorari should be denied.

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Respectfully submitted,

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